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Black Money and Rural Development—Remittance Services

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Black Money and Rural Development—Remittance Services

One of the most crucial functions of financial services is the remittance of funds, particularly over long distances. Because of the possibility for offsetting clearance, and various forms of safe financing often connected with it, this service is typically one of the first demanded in many communities—especially by the millions of migrant workers scattered far from their land.

Formal and Informal Remittance Systems

In a formal remittance system, middle class remitters go to their bank and buy a telegraphic remittance or write a check and send it to the person to be paid. Carefully recorded and subject to audit, these transactions often comply with various laws and regulations. These services tend to be expensive. For this reason the bulk of the business is handled, in many developing countries and between them and the developed countries, by informal organizations that avoid regulation and monitoring and that sometimes are characterized by collusive monopolization.

In an informal remittance system, a dealer, often a storeowner, receives cash and instructs, directly or through a chain of intermediaries, a counterpart to pay someone in another place. Written transaction records and outside audits are rare, and currency conversion laws and regulations may be violated. Often the dealer and counterpart have a social, familial, or ethnic link—or there are such links somewhere along the chain between them. Along that chain various remittance orders can offset one another so that relatively small balances have to be remitted. Storeowners and other merchants are often involved, partially because they have remittance needs in connection with their businesses that permit such offsetting. Depending on the complexity of the transaction, informal insurance may be available and credit may be extended and secured against expected remittances. For example, the order to pay may require payment within 90 days or require the payee to do something (e.g., produce a bill of lading for goods sent). This informal system is popular among many migrants and small businessmen who have no entrée to or confidence in commercial banks, or for whom commercial services are too expensive, seem unreliable, or are simply unavailable.

Because many informal remittance systems for small transactors violate currency conversion laws they deal, by definition, in “black money.” Such money is also associated with tax evasion, smuggling, drug trafficking, terrorism, or other organized criminal activity. But the informal remittance system involves a number of different parties and is not suitable for moving large amounts of funds. In addition, black money is a restricted currency, useful only for transactions that are hard to trace, and thus often has to be complemented with legal, “white money” for some sorts of transactions.

Informal remittance systems have been in place for thousands of years. Though innovations such as the telephone and Internet are now used, the basic tool is still the nexus between two contact points, each of whom will pay or receive in combination with the other. With sophistication develops various sorts of use of the float, interaction with formal sector financial institutions, and multilateral clearance of accounts. The logical modes for the money remittance function are small retailers in intimate contact with clients on both ends. They have the clients and usually some ready money with them. The challenge is to integrate them into a broader remittance system.

Havala Systems

Havala, informal remittance systems in the Middle East, have been the normal way to move money around the region for some time, but have come under special attention because Al-Qaida use them. In fact, for the entire period of the Afghan Civil Wars (1980–2001), a good deal of the financing of all parties moved through *havala* channels.

I first came across the system in the 1970s in Bombay, when Sindhi Hindu merchants—originally from Sind now in Pakistan—handled a good deal of the remittance from Middle East migrants.[2] They worked out of a group of offices in the Churchgate neighborhood of Bombay. Smaller centers existed throughout India and, as I discovered in the 1980s, in Pakistan and Bangladesh. The owners of the offices in Bangladesh were Marwaris, Hindu merchants originally from Rajasthan, who had given up almost any other direct economic activity in Bangladesh; in Pakistan they were members of the Muslim trading ethnic communities. The vast majority of the remittance in South Asia was routine, though not a little paralleled the flourishing smuggling trade from the Gulf. From time to time, Indian banks tried to compete for this remittance business, but their costs were usually too high and their marketing not innovative.

[2] Thomas A. Timberg and C.V. Aiyar. 1984. Informal Credit Markets in India. *Economic Development and Cultural Change.* Sindhis, Marwaris, and the Muslim trading groups are ethnic groups that share a common region of origin or sectarian affiliation, and in which most men are involved in trade and commerce.

In the early 1990s, I studied the *havala* phenomenon in Peshawar and Karachi as it related to Afghanistan.[3] The late Maxwell Fry ably described the system in that country. In Fry's day most of the traders in Kabul were Jewish and in Kandahar Hindu and Sikh. Most Jews left in the 1960s.[4] When I passed through Kabul in 1971 I noticed men sitting at card tables in Sarai Shahzada, a semi-covered structure, with piles of various currencies and sometimes a telephone, handling money change and remittance. Da Bank Milli, the central and largest bank, had little retail presence.

By the 1990s, the traders in Kabul and Peshawar were all Pashtuns, some of whom I interviewed (in Peshawar, since the peculiarities of U.S. Government rules meant that we could send Germans and French into Afghanistan but not U.S. citizens). Their correspondents in Karachi were mostly Memons, a Gujerati-speaking trading community, mostly refugee from India.

Economic Development and Remittance System Reform in Afghanistan

Today, concerns about the relationship between the unregulated flow of money and terrorism are generating interest in substituting a more institutionalized and regulated financial structure. But one can only be doubtful about the success of such a substitution if regulated structures cannot compete with existing businesses. The January 9, 2003 *Financial Times* reports on an interview with a moneychanger on the pavement in front of the Afghan Central Bank. This suggests that informal remittance is alive and well in Afghanistan. The present repression of some of the leading money remittance networks may be successful for a time, but institutionalizing money remittance will require some imagination.

The World Resources Institute, as part of its "marketing to the base" initiative called the Digital Dividend Project, is exploring setting up modern remittance systems to serve rural poor.[5] South African banks have experimented successfully with the use of debit card machines in isolated areas to help with South Africa's remittances, including

[3] Thomas A. Timberg. 1991. Afghan Financial System. Washington, DC: Afghanistan Studies Project.
[4] Maxwell Fry. 1974. *The Afghanistan Economy: Money, Finance and the Critical Constraints to Economic Development*. Leiden: Brill.
[5] See http://www.digitaldividend.org and, more specifically, a study of the commercial possibilities of Latin American remittances, "Billions in Motion: Latino immigrants, Remittances, and Banking," on the PEW Hispanic Center website.

various sorts of social income that exist in that country.[6] But the experiment so far is limited.

Alternatively, a regulatory network could be developed with the informal remitters. On the one hand, this would require a profound social and psychological stretch for those who man the networks and for the regulators. On the other hand, informal remitters typically have to know their clients very well in order to deal with them as they do, so they are well equipped to cooperate in stopping or reporting flows of noxious funds.

Moises Naim makes a parallel point in "The Five Wars of Globalization," in the January-February 2003 issue of *Foreign Policy*, where he recognizes the challenges of "bureaucracies fighting networks" in the case of all sorts of informal trading networks (e.g., money, drugs, arms) and the difficulty of "going against market forces." He suggests that we "devise new mechanisms and institutions" such as that proposed by the Center for Global Development and "move from repression to regulation."[7]

The alternatives of competition and regulation both leave open the question of next steps in financial development. That is, on the basis of a good remittance system, a good system of intermediation, savings, and credit, needs to be developed. Attractive savings deposit facilities (though the competition is often limited and depositors will accept quite low returns) as well as credit facilities must be developed.

This has been the traditional path to develop financial systems and there is no reason to think it will not recur in Afghanistan. The more easily sustainable forms of credit will not be the new enterprise facilities on which attention has been focused, but more easily monitored trade credit, credit against receivables and goods in transit, pawnbroking, and whenever the land tenure situation clears up, perhaps some lending secured by real estate. But even real estate finance should not be rushed. The United States wisely kept commercial banks from lending against real estate for more than a century. And American taxpayers might have been well served if that policy had been continued. Real estate gives the illusion of solidity. In the American case of residential real estate secured against the income of American homeowners the solidity may be real. But for other countries, the value of real estate and the ability to transfer and deal with it is limited.

In both saving and lending, standard financial institutions will find it difficult to provide services, and the informal financial system is likely to continue to be the primary provider in the rural and poorer sectors of many countries. India, for example, has

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[6] Jo Ann Paulson and James McAndrews. Financial Services for the Urban Poor: South Africa's E-Plan, from Internet. Also http://www.enterplan.co.uk/CFProjectPortfolio.htm for UK projects in Africa

[7] Fry, pp. 28-37.

aggressively promoted banks and highly regulated financial cooperatives for more than half a century but well over a quarter of all legal and reported lending is still done through informal channels to say nothing of the volume of lending off the books.[8]

[8] Karmachandra Rao. 2001. Indebtedness of Households. *Economic and Political Weekly*. May 12.